April 2011

Public pensions remained the focus of many lawmakers in April, with a House of Representatives committee holding another hearing on the subject, this one featuring Wisconsin Gov. Scott Walker, who described his controversial efforts to reduce spending on benefits for state workers. A Pew Center report, meanwhile, found that states have unfunded pension liabilities of $660 billion and unfunded retiree health care liabilities of $635 billion. The estimates, though, were based on 2009 numbers, and a separate report released by the National Association of State Retirement Administrators found that pension assets increased significantly in 2010 as the economy recovered and are now nearly at pre-recession levels.

Issues and Events

Costs, Benefits of Health Care Reform Debated at Hearing

The 2010 health care reform law will either reduce deficits and improve the health care system or be a budget buster that damages the economy, depending on whom was speaking at a congressional hearing in late March.

The House Energy and Commerce Committee’s Subcommittee on Health on March 30 held a hearing on “True Cost of PPACA: Effects on the Budget and Jobs.” The full committee’s chairman, Rep. Fred Upton, R-Mich., has been helping to lead Republican efforts to undo the “Patient Protection and Affordable Care Act” (PPACA).

Congressional Budget Office (CBO) Director Douglas Elmendorf reiterated his agency’s projections that the law will reduce federal deficits by $210 billion through 2020 and increase the number of people who have insurance in 2016 by 32 million.

David Cutler, professor of applied economics at Harvard University, told lawmakers that the law would reduce wasteful spending, cutting national health care costs by $500 billion in the first decade, $3.5 trillion in the second and $5 trillion in the third.

"The Affordable Care Act will save money not by mandating any specific level of savings, but by incentivizing better care," Cutler said. "Insurance premiums would decline with reductions in overall medical spending, and this would lead firms to hire more workers."

But Phil Kennedy, president of Comanche Lumber of Lawton Okla., speaking on behalf of the U.S. Chamber of Commerce, said that the law will increase costs for his business and contains "onerous mandates and provisions which saddle businesses with burdens that actually encourage us not to expand our business and, astoundingly, discourage job creation."

"The [coverage] mandate will basically punish businesses that have 50 or more employees by fining them if they don't offer a certain level of coverage," Kennedy said. "Even if a business does offer a 'qualified plan,' it still might be fined just as much. Ironically, the fine for businesses that don't offer coverage is $2,000 per employee, and the fine for a business that does offer coverage is $3,000 per employee, plus the cost they're paying for coverage. In other words, it may be more cost-effective for Comanche to drop its coverage under the new mandate."

Similarly, Douglas Holtz-Eakin, president of American Action Forum and former director of the Congressional Budget Office, said that the law will hurt the economy, increase insurance costs and encourage employers to drop coverage. Holtz-Eakin also criticized calculations that he called "accounting sleight of hand" and said that the law will be expensive for the federal government.

"What is the bottom line," Holtz-Eakin asked. "Removing the potentially unrealistic annual savings, reflecting the full costs of implementing the programs, acknowledging the unlikelihood of raising all of the promised revenues, and preserving premiums for the programs they are intended to finance, produces a radically different bottom line [than CBO has projected]. The Act generates additional deficits of $562 billion in the first ten years. And, as the nation would be on the hook for two more entitlement programs rapidly expanding as far as the eye can see, the deficit in the second ten years would approach $1.5 trillion."

House Panel Examines Costs of Financial Reform

The 2010 financial regulations reform bill is projected to reduce federal budget deficits by $3.2 billion through 2020, the director of the Congressional Budget Office told Congress (CBO) on March 30, but a former CBO director countered that the budgetary costs are "likely the smallest costs" associated with the bill.

At a hearing before the House Financial Services Committee's Subcommittee on Oversight and Investigations, CBO Director Douglas Elmendorf said that the reform law, known as Dodd-Frank, would increase federal spending by $10.2 billion and revenues by $13.4 billion through 2020. One of his predecessors at the CBO, Douglas Holtz-Eakin, said, however, that that does not present a complete picture of the law's costs.

"Financial regulation imposes budgetary costs on the taxpayer," Holtz-Eakin, who is now president of American Action Forum, said. "In addition, it imposes direct compliance costs, and its distortions induce economic costs in the form of reduced capital investment, inferior risk-sharing and lost competitiveness. Because of its scope and scale, Dodd-Frank will impose substantial costs of each type. … The economic consequences of Dodd-Frank will be to reduce investment in the United States."

The law, Holtz-Eakin said, will "make capital market transactions more expensive," producing "slower near-term GDP growth from Dodd-Frank [which] would also translate into slower labor market recovery."

James Angel, associate professor of finance at Georgetown University's McDonough School of Business, similarly warned that "Dodd-Frank contains many provisions which, if implemented badly, could be much more costly than anticipated and have serious adverse consequences for our economy." He cited the Volcker rule, which limits proprietary trading by banks; risk retention rules for issuers of asset-backed securities; regulation of over-the-counter derivatives; and ability to prepay requirements for mortgages.

David Min, associate director for financial markets policy at the Center for American Progress Action Fund, noted, however, that, while the regulations will have budgetary and economic costs, they are intended prevent a recurrence of the recent financial crisis, which itself destroyed $10 trillion in household wealth. The reform law, he said, "will meaningfully reduce leverage and increase transparency – and thus reduce systemic risk – provided that it is fully and effectively implemented."

"Even the most pessimistic cost estimates for implementing Dodd-Frank constitute just a small percentage of the probable benefits of financial stability," Min said. "Even if one does not believe Dodd-Frank solves all of our financial market issues, it is clear that by reducing systemic risk, and thus the likelihood of financial crises and the large losses that accompany these, Dodd-Frank pays for itself many times over.

Jeffrey Lacker, president of the Federal Reserve Bank of Richmond, focused his remarks on the role that expectations of government protection had in encouraging the failed ventures that contributed to the financial crisis. The crisis, he said, "resulted largely from a mismatch between a regulatory structure designed for the explicit safety net (consisting mainly of deposit insurance) and the extent of moral hazard induced by a much broader implicit safety net."

"In the near term, I believe regulators have a firm grasp on the industry, and are taking strong steps to tighten risk management at regulated firms, but there are risks in the long term because firms seen as enjoying broad safety net protection will have strong incentives to take on excessive risks," Lacker said. "And firms will have an incentive to bypass regulation, if they can still enjoy some degree of implicit protection. This desire to operate just outside the perimeter of regulation, but within the implicit safety net, will present ongoing supervisory and regulatory challenges – and may make it difficult to prevent or limit the magnitude of future crises."

The chairman of the Financial Services Committee, Rep. Spencer Bachus, R-Ala., is one of the leading critics of the Dodd-Frank law, and the majority Republicans in the House have set a (probably unattainable) goal of dismantling it.

Most Retirement Plan Tax Benefits Enjoyed by Higher Income Workers: GAO

About half of private-sector workers do not have access to a retirement plan, and among the 50 percent who do, most of the pension-related tax benefits are enjoyed by those with higher incomes, according to a report from the Government Accountability Office (GAO).

The GAO found that single-employer private pension plans increased by a net of only 1 percent between 2003 and 2007 to 705,000, enough to cover about half of the private workforce. All but 8 percent of the roughly 180,000 plans created during this time were defined contribution plans. (Plan terminations between 2003 and 2007 also totaled nearly 180,000.)

"The low net growth of private retirement plans is a concern in part because workers without employer-sponsored plans do not benefit as fully from tax incentives as workers that have employer-sponsored plans," the report noted.

A disproportionate share of the $100 billion in annual tax incentives, however, benefit higher-income workers, the GAO found, with nearly three-fourths of individuals who maxed out their contributions to their retirement accounts – and, thus, enjoyed the greatest tax benefits – having earnings in the 90th percentile ($126,000 a year) or higher. The GAO examined several options for modifying the Saver's Credit – a retirement savings tax credit for people with lower incomes – but found that the resulting increases in retirement income were generally "not substantial," though certain revisions could provide significant increases in income to a small group of workers.

"For many American workers and their families, the challenges to retirement security are very real," the GAO concluded. "Fostering retirement income security, especially for low- and middle-income workers, may require a serious review of current government efforts to assist workers in achieving adequate retirement income."

Appeals Court to Hear Health Care Reform Case on June 8

A federal appeals court is scheduled to hear arguments regarding the constitutionality of the health care reform law on June 8.

U.S. District Court Judge Roger Vinson in January ruled against the law in a case filed by 26 state attorneys general, saying its requirement that every American have health insurance is unconstitutional and that, since that provision is so intricately tied into other aspects of the legislation, the entire law must be struck down. On March 3, Vinson stayed his ruling, pending appeal, on the condition that the Obama administration seek an expedited appellate court review, writing, "The sooner this issue is finally decided by the Supreme Court, the better off the entire nation will be."

The administration was granted its request for an expedited ruling, which could mean that the case will reach the U.S. Supreme Court this year or in early 2012. The individual mandate is scheduled to go into effect in 2014.

Several other challenges to the law are pending in other courts.

Bailout Programs Expected to Turn Profit for Federal Government

TARP and other bailout programs instituted by the federal government during the financial crisis are expected, overall, to turn a profit of $23.6 billion, according to a new analysis released by the U.S. Treasury Department.

While the Troubled Asset Relief Program (TARP) and related assistance to AIG is expected to cost $28.1 billion, and the preferred stock purchase agreement with Fannie Mae and Freddie Mac is projected to cost $73 billion, other programs are expected to more than make up for those losses. Federal Reserve programs are expected to make $110 billion, Treasury Department mortgage-backed securities purchases $13.5 billion and Treasury's Temporary Guaranty Program for Money Market Funds $1.2 billion. Federal Deposit Insurance Corporation (FDIC) programs, meanwhile, are expected to break even.

Treasury also announced that the federal government has now turned a profit on the bank portion of the TARP program.

The TARP provided $245 billion to banks to help them weather the financial crisis, and those institutions have returned $251 billion.

"While our overriding objective with TARP was to break the back of the financial crisis and save American jobs, the fact that our investment in banks has also delivered a significant profit for taxpayers is a welcome development," Treasury Secretary Tim Geithner said. "We still have more work to do repairing the damage caused by the crisis and strengthening the recovery, but today is an important milestone in our efforts to recover taxpayer dollars as we continue winding down TARP."

RELATED NATIONAL AND INDUSTRY NEWS

Report Finds that States Face $1.26 Trillion Shortfall in Funding for Retirement Benefits

The shortfall in funding for retirement benefits for state employees totaled $1.26 trillion in 2009, a 26 percent increase over the previous year, according to a report released in late April by the Pew Center on the States.

While the gap was about evenly split between pension and health care benefits, state pension plans are 78 percent funded, while retiree health care benefits are only 5 percent funded.

The report found that states have $2.28 trillion in funding for $2.94 trillion in pension liabilities and that, in 2009, they contributed $73 billion to pensions, just 64 percent of the $115 billion that had been recommended by actuaries. California's $491 billion pension liability is 81 percent funded, and the state contributed 82 percent of the actuarially recommended amount of $12.4 billion in 2009, according to the report.

The report noted that the value of assets in state pension plans dropped a record 19.1 percent in 2009, and that, "For most states, whose fiscal year 2009 began on July 1, 2008 and ended on June 30, 2009, these data capture the worst effects of the financial crisis. More recently, many plans have reported double-digit investment gains for fiscal year 2010."

The report used states' own data, and states typically discount required contributions by using an investment return assumption of around 8 percent. While pension officials note that this is based on historical returns, some critics say that this discounting is inappropriate and argue that forecasts of pension liabilities should be based on "risk-free" rates of return, which generally means the roughly 4 percent that would be provided by Treasury bonds.

"This is an important issue because, depending on how those liabilities are calculated, states' total funding shortfall for their long-term pension obligations to public sector retirees could be as much as $1.8 trillion (using assumptions similar to corporate pensions) or $2.4 trillion (using a discount rate based on a 30-year Treasury bond)," the report stated. "How states value long-term liabilities going forward will play an important role in defining the scale of their challenges and the actions they will have to take to meet them."

Rep. Devin Nunes, R-Calif., has proposed the "Public Employee Pension Transparency Act" (H.R. 567), which would require state and local pension funds to disclose their liabilities as calculated using a "risk-free" rate of return and would prohibit federal bailouts of public pensions. The House Ways and Means Committee's Oversight Subcommittee was scheduled to hold a hearing on the bill and related pension funding issues on May 5. A companion measure has been introduced in the Senate by Sen. Richard Burr, R-N.C.

As for retiree health benefits, states, in 2009, had funded $31 billion of their $635 billion in liabilities. California had funded 0.1 percent of its $67 billion in liabilities, and it contributed 31 percent of the actuarially recommended amount of $5.5 billion in 2009.

Public Pension Assets Nearly at Pre-Recession Levels: Report

Public pension assets have nearly recovered to pre-recession levels, according to a report jointly issued by NASRA and NCTR.

The issue brief from the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR) found that, as of Dec. 31, 2010, state and local pension fund assets nationwide total $2.93 trillion, an increase of more than one-third from their low point during the nation's financial meltdown, but still below their 2007 level of $3.2 trillion.

In addition, the report noted that assets are 25 percent higher than they were on June 30, 2009, the point at which many studies that are critical of public pensions have gathered their data. (A May 2010 report from Northwestern University Professor Joshua Rauh that predicted the collapse of many public pensions within 10 to 20 years and has received extensive press coverage used data from September 2009, at which point, according to Rauh, pensions had a combined $2.2 trillion in assets.)

"The use of point-in-time measures, particularly at the low-point of the market recovery, can present a distorted or misleading picture of the condition of public pensions," the report noted. "The use of such measures also underscores the need for policymakers to closely analyze long-term programs such as state and local government retirement systems in order to avoid making major policy decisions based on short-term and outdated information."

The study also found that, while annual investment returns over the past three, five and, even, 10 years have been below expectations; yearly returns over the past 25 years have averaged 8.8 percent, which is higher than the assumptions used by most funds.

Report Suggests New Pension Benefit Model

A report from Boston College's Center for Retirement Research concluded that, "Defined contribution plans may well have a role in the public sector, but in combination with, not as an alternative to, defined benefit plans."

The report examined the various aspects of defined contribution and defined benefit plans, including costs, risks and benefits, and looked at hybrid plans that were recently implemented in Georgia, Michigan and Utah. The researchers then offered their own suggestion for a "stacked" hybrid plan in which public sector workers would have a defined benefit plan based on a certain amount of their wages – say, the first $50,000 – and a defined contribution plan on amounts above that.

"The advantage of the "stacked" approach is that it allows employees with modest earnings to receive the full protection of a defined benefit plan," the report stated. "This group would be the most vulnerable if required to rely on a 401(k) for a portion of their core retirement benefit. … More highly-paid public employees would still have the protection of a defined benefit plan as a base and would then rely on the 401(k) for earnings replacement that exceeded the earnings of a typical private sector worker. This overall arrangement offers a reasonable balance by providing adequate and secure benefits targeted to public employees who need them most while limiting the risk to taxpayers of covering large pension shortfalls."

The report was produced Alicia Munnell, Jean-Pierre Aubry, Josh Hurwitz and Laura Quinby.

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

GOP Reps. Again Call for Public Pensions to be More 'Transparent'

Republican lawmakers in mid-April again criticized public pensions and what they say are failures by states and localities to disclose fully the funds' finances.

The House Oversight and Government Reform Committee on April 14 held a hearing to follow up on two sessions held this year by one of its subcommittees in which Republican members frequently criticized public pension financing.

At the most recent hearing, Rep. Patrick McHenry, R-N.C., said that "shadow accounting" has allowed states to keep unfunded pension liabilities off their books.

"We're not facing a revenue problem," McHenry said. "It's a spending problem. But as always, the numbers don't lie."

Committee Chairman Darrell Issa, R-Calif., meanwhile, lamented that, "The [municipal] bond markets are not transparent, and the reporting rules do not force adequate disclosure."

After the hearing, Issa plugged the "Public Employee Pension Transparency Act" (H.R. 567), a bill sponsored by Rep. Devin Nunes, R-Calif., that would require state and local pension funds to disclose their liabilities as calculated using a "risk-free" rate of return – essentially, what would be expected from Treasury bonds – and would prohibit federal bailouts of public pensions. A companion measure has been introduced in the Senate by Sen. Richard Burr, R-N.C.

"We don't have transparency," Issa said. "We don't know how big a hit [pensions] took. … "There's no logical reason for the states to maintain secrecy."

University of Rochester Professor Robert Novy-Marx similarly said that "The exact magnitude of the [pension underfunding] problem has been concealed by the flawed accounting methodology prescribed by the Governmental Accounting Standards Board" (GASB). He said that unfunded pension liabilities nationwide total $3 trillion, and arguing that they are only one-third that size by assuming an 8 percent return on investments – which is based on the historical rate – "insults common sense."

"This logic is clearly flawed," Novy-Marx said. "A dollar of stock is not worth more than a dollar of bonds. When you, as an individual, move money from a money market fund into the stock market, you are not suddenly richer. You do not get to pretend that you owe less on your home mortgage. The payments you are obligated to make on your house are completely unchanged. How you invest your assets has no impact on the current value of your liabilities. This is just as true for the states as it is for individuals, despite GASB's claims to the contrary."

Novy-Marx, who has worked with Northwestern University Professor Joshua Rauh on papers that have described the pension funding situation in many states as "dire," endorsed Nunes' legislation said that Congress should consider doing even more, including providing "incentives for states to close current plans to new workers, and to instead enroll new hires in transparent defined contribution plans and Social Security."

Novy-Marx appeared on the hearing's second panel with representatives of three conservative organizations. Wisconsin Republican Gov. Scott Walker was one of two witnesses on the first panel, and much of the discussion during that segment veered into a debate about collective bargaining by public employees. Walker recounted the changes made in his state to public sector benefits and collective bargaining rights this year and said they were done to protect "middle-class jobs and middle-class taxpayers."

"What we did are permanent, long-term solutions," Walker said. "I have never said an ill word of any of the decent public servants. … We need to make changes to make sure their jobs are protected."

Vermont Democratic Gov. Peter Shumlin, however, said he addressed his state's budget shortfall by negotiating pay and benefit changes with public employee unions.

"My point is: if you want to go after collective bargaining and the fact that it helped build this country and that it helped build the middle class that is under assault in this recession, just come out and say it," Shumlin said. "But if you want to balance your budget, you bring people in. You talk to them."

Both Walker and Shumlin expressed opposition to a proposal that has been offered by some Republicans to allow states to declare bankruptcy.

House Votes to Strip EPA of Authority to Regulate Greenhouse Gases

The House of Representatives on April 7 voted to strip the EPA of its authority to regulate greenhouse gases to counter climate change, but the Senate appears unlikely to approve the bill.

EPA rules that went into effect on Jan. 2 require states to review air pollution permits from power plants and other major pollution sources for compliance with the Clean Air Act. The agency's assertion of its authority to regulate greenhouse gas emissions is highly unpopular with many representatives of industry and GOP lawmakers, who argue that it will slow the economy.

The GOP-controlled House voted 255-172 to pass the "Energy Tax Prevention Act" (H.R. 910) from Energy and Commerce Committee Chairman Fred Upton, which would amend the Clean Air Act to prohibit the Environmental Protection Agency (EPA) from regulating "the emission of a greenhouse gas to address climate change." Nineteen Democrats voted for the legislation.

“Our thoughtful, bipartisan solution reins in an EPA gone wild whose bureaucrats are oblivious to the nation’s economic woes and soaring unemployment,” Upton said. “The EPA’s regulatory bonanza will cause already soaring gas prices to rise even higher as refiners are caught in the EPA's web of costly regulations. With gas prices eclipsing $4 per gallon, the last thing families can afford are misguided government policies that make the price at the pump even higher. At the end of the day, the EPA climate regime is all economic pain and no environmental gain – today’s vote is an important victory for American families, and our efforts are gaining even more momentum.”

In the Senate on April 6, though, a similar proposal received only 50 votes – including four from Democrats – 10 short of the number needed to defeat a likely filibuster by most Democrats, making passage of Upton's bill highly unlikely. President Obama has pledged to veto any such legislation, should it reach his desk, and a White House spokesman praised the Senate’s rejection of “an approach that would have increased the nation’s dependence on oil, contradicted the scientific consensus on global warming, and jeopardized America's ability to lead the world in the clean energy economy.”

The Senate also voted down three proposals from Democrats related to the EPA’s new regulations, including one from Sen. Jay Rockefeller of West Virginia, which would have put the regulations on hold for two years.

Rep. Henry Waxman, D-Calif., ranking member of the House Energy and Commerce Committee and sponsor of a 2009 bill that passed the House that would have created a cap-and-trade system for carbon emissions, called the House bill “a divisive, partisan measure that takes us in exactly the wrong direction.”

“Americans want clean air to breathe and sensible limits on carbon pollution,” Waxman said.